
Purchase Cards¹

Shell Company

A Department of Defense agency requested an audit of its purchase card program when a quarterly review of cardholder transactions showed an increase of one hundred transactions, totaling over \$150,000 occurring in the last six months of the year. This increase resulted in 25% more purchase card transactions when compared to the same period in the last calendar year. Auditor analysis showed that the number of authorized purchase card users remained constant, despite the increase in purchase card activity. Agency management stated that there was not a specific event or change in mission requirements that could have caused the increase in purchasing activity. The auditor selected a sample of purchase card transactions and supporting documentation and observed the following trends:

- Numerous missing invoices, receipts, and purchase justifications.
- An excessive number of receipts containing date changes, and changes to product descriptions. In some instances, the receipts were illegible and the auditor could not determine what item(s) were actually purchased. However, the majority of the hard to read receipts appeared to be for computer equipment.
- Review of the purchase card transaction records showed fifty laptops were purchased by the agency. However, they could not be located in agency inventory records.
- A pattern of favoritism to Vendor B, which was supposedly located within walking distance from the agency.

During lunch, the auditor decided to walk to Vendor B to see if they could verify the delivery of the fifty lap top computers. When the auditor arrived at the vendor address they discovered a florist. The flower shop owner stated that the company had owned the building for over twenty years. When the auditor returned to work, they expanded their review of sales to Vendor B and observed the following:

- Employee A purchased 100% of the suspect equipment from Vendor B. The cost of each computer was billed as \$2,999.00. Review of supporting documentation showed that none of the transactions had the required purchase justifications and all lacked evidence of receipt by an independent party.

¹The Government Accountability Office's Purchase Card Audit Guide uses the following definitions when describing Government purchase card misuse: (1) an improper purchase is one for government use but is not permitted by law, regulation, or organizational policy, (2) an unauthorized purchase is a purchase of goods or services that is unauthorized and intended for personal use or gain, (3) an abusive purchase is a purchase of authorized goods or services that is excessive, for a questionable Government need, or both.

- Employee A was the only cardholder that purchased items from Vendor B.
- Purchase card records showed that Employee A purchased one computer each day during the most recent thirty day period. However, the agency had not increased its staffing and all employees received new computers during the last fiscal year.
- Employee A used ten convenience checks to purchase thumb drives from Vendor B.
- Auditor research at the State Corporation Commission disclosed that Vendor B was not incorporated. Additional research showed that Vendor B was not listed in any area business directories.

The auditor suspected that Vendor B might be a shell company and decided to interview Employee A to obtain more information about the suspect equipment purchases. During the interview, Employee A stated that Vendor B was a company that they created to bill the agency for equipment that was never purchased or received. Employee A stated that they originally started the scam to see if it would work, became greedy, and continued to use the Government credit card to make phony purchases. Employee A also knew that the agency did not conduct periodic reviews of cardholder purchases and inventory records and thought that the phony purchases would never be detected. Employee A created some of the illegible receipts and invoices when they were too lazy to use their home computer and print out new supporting documentation. Agency policies and procedures did require purchase justifications and independent receipt and acceptance of purchases but Employee A's supervisor ignored these requirements.

General Comments / Lessons Learned. In general, when conducting purchase card reviews, it is important for auditors to remain skeptical of repeat purchases from the same vendor or groups of vendors, which can indicate that the cardholder is not complying with competitive bidding requirements. Auditors should also be alert to repeat transactions that fall slightly below the established micropurchase threshold of \$3,000, which is another common scheme used to conceal split purchase transactions and/or avoid competitive bidding procedures. Another area of concern is a pattern of repeat purchases from specific vendors being made by one employee or small groups of employees. If auditors have doubts regarding the authenticity of a vendor, research should be conducted to determine if the vendor actually exists. Similarly, convenience checks are designed for use when merchants do not accept purchase cards. Auditor analysis of an organization's use of convenience checks can also assist with detecting suspect purchase card transactions.

Suspect Purchases

The auditor used data mining techniques* to identify suspect purchase card transactions using the following indicators: transactions that occurred on week ends, purchases from unauthorized vendors, and cardholders with three or more disputed purchases occurring in the past six months. Data mining identified twelve suspect transactions in the sample population. Sample transactions had the following characteristics:

- One employee purchased gasoline, totaling \$200.00, while traveling on a two day Temporary Duty assignment. Transaction records showed that the employee rented a compact car during their trip. The same employee used their government purchase card to buy gasoline on the Saturday and Sunday following their return home.
- Three employees made suspect purchases including an online dating service subscription, baby diapers, and children's clothing. Auditor research disclosed that the cardholder responsible for the diaper purchase worked in a Government sponsored day-care center. Therefore, the auditor considered this transaction a false positive. However, review of supporting documentation for the online dating subscription and the children's clothing disclosed that agency designated approving officials did not authorize these transactions.
- One cardholder had more than three disputed transactions in the past six months. Example disputed charges included two iPods and one DVD player.
- Several of the purchased items were reported as lost, missing or stolen. Some of the most common lost items included lap top computers, thumb drives, and digital cameras.

The auditor interviewed agency management and discovered that they were not conducting periodic reviews of cardholder transactions. A supervisor stated that the employee responsible for the disputed purchases no longer worked at the agency; however, they continued to use their Government purchase card. Agency managers agreed with the auditor's conclusion that the suspect transactions showed a pattern of purchase card misuse at the agency, which was caused by weak internal controls.

General Comments / Lessons Learned. Data mining is a useful tool for auditors when conducting purchase card reviews. However, data mining techniques can sometimes identify transactions that are not suspect, as illustrated in the scenario example of the cardholder purchase of diapers for a Government sponsored day care center. When evaluating suspect purchase card transactions, auditors should also review supporting documentation and conduct interviews with agency personnel, as needed, to assist with

* Data mining is a generally computer-based process of knowledge discovery and prediction that involves sorting through large amounts of data and picking out relevant information and looking for patterns. (http://en.wikipedia.org/wiki/data_mining)

determining the validity of the purchase. Auditors should also be alert to purchases of pilferable items that are repeatedly reported as lost, missing, or stolen, because this may indicate a pattern of ongoing employee theft.

FRAUD INDICATORS

- **Significant increase in an organization's purchase card use without an increase in the number of authorized purchase card users and/or change in agency mission or responsibilities.**
- **Numerous missing invoices, receipts, and purchase justifications.**
- **Receipts contain "white-outs," date changes, and changes to product descriptions, or are illegible.**
- **Purchased items are not recorded in inventory records.**
- **Pattern of repeat favoritism to a specific vendor or group of vendors.**
- **Purchases fall at, or slightly below, the purchase threshold of \$3,000.**
- **Absence of independent receipt and acceptance of purchased items.**
- **Convenience checks are used to pay vendors that also accept Government purchase cards.**
- **Organization does not conduct periodic reviews of cardholder purchases and inventory records.**
- **One cardholder, or a small number of cardholders, makes repeat purchases from a specific vendor.**
- **Research shows that a vendor or company may not be authentic (i.e. phony business address or no evidence that the company is incorporated, etc.).**
- **Management does not follow established purchase card procedures such as requiring purchase justifications, independent receipt and acceptance of purchased items, and periodic reviews of cardholder transactions.**
- **Cardholder makes unauthorized week-end purchases.**
- **Cardholder pays an excessive amount for routine purchases.**

- **Pattern of suspect cardholder purchases from unauthorized vendors such as clothing stores or suspect online vendors.**
- **Pattern of cardholder accounts with disputed charges.**
- **Pilferable items are repeatedly reported as lost, missing, or stolen.**
- **Separated employees continue to make purchases using the Government purchase card.**

OTHER FRAUD INDICATORS

In the previous scenarios, we have described various fraud indicators that auditors may find during purchase card reviews. Below are some additional fraud indicators that auditors may encounter during these types of audits:

- Inadequate separation of duties such as cardholders approving their own purchase authorizations.
- Purchase logs do not contain descriptions of items purchased.
- Cardholder and vendor have the same name.
- Cardholder account records are incomplete.
- Cardholder accounts with several limit increases occurring within a short time.
- Cardholder purchases exceed the authorized card limit.
- Account payments are frequently delinquent.
- Purchases appear to be outside of the normal purchase pattern of the cardholder.
- Similar invoices from different vendors.
- Subversion of management controls by the cardholder and/or approving authority.
- Cardholder files contain new documents and signatures.
- Excessive number of cardholders within an activity or unit.
- Purchases items are available through the supply system.

- Cardholder does not turn in premiums/free products obtained with purchases.
- Organization has no established controls over purchases returned to stores for cash.
- One purchase card assigned to an office or group of individuals instead of a specific person.
- An excessive number of cardholders are assigned to one approving official.